

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2008-435-E - ORDER NO. 2009-38

FEBRUARY 11, 2009

IN RE: Petition of Progress Energy Carolinas, Inc.)	ACCOUNTING ORDER
for Authorization to Defer as a Regulatory)	
Asset the Depreciation Expense and)	
Incremental Operation and Maintenance)	
Expenses That Will Be Incurred to Install)	
Pollution Control Facilities)	

This matter comes before the Public Service Commission of South Carolina (“Commission”) on the petition of Progress Energy Carolinas, Inc. (“PEC”) for an accounting order for regulatory accounting purposes authorizing PEC to begin deferring as a regulatory asset: (i) the depreciation expense that the Company incurs on its environmental compliance control facilities; and (ii) the incremental operation and maintenance expenses that PEC incurs in connection with its environmental compliance control facilities. In support of its request, PEC submits the following:

In September 1998, the United States Environmental Protection Agency (“EPA”) issued a rule commonly known as the NOx SIP Call, which established an annual Ozone Season and required affected states to revise their State Implementation Plans (“SIP”) to reflect the nitrogen oxide (“NOx”) emission reductions necessary to meet the NOx SIP Call limits beginning with the 2004 Ozone Season. In response to the NOx SIP Call, both the North and South Carolina SIPs were revised and approved by the EPA. In order to comply with the NOx SIP Call emissions requirements, it was necessary for PEC to

install NO_x controls on many of its generating units. The NO_x controls consisted primarily of Selective Catalytic Reduction (“SCR”) and Selective Non-Catalytic Reduction (“SNCR”) equipment. The controls necessary for compliance with the NO_x SIP Call were installed beginning in 2000 and were completed in 2006.

In 2002, the North Carolina General Assembly passed the Clean Smokestacks Act (“CSA”) which required PEC to reduce its total annual emissions of sulfur dioxide (“SO₂”) from its coal-fired plants to 100,000 tons by 2009 and further reduce such emissions to 50,000 tons by 2013. The CSA also required PEC to reduce its total annual emissions of NO_x from its coal-fired plants to 25,000 tons by 2007. To comply with the CSA it was necessary for PEC to install additional NO_x controls (beyond those required to comply with the NO_x SIP Call) and SO₂ controls on many of its coal-fired generating units. The additional NO_x controls consisted of a combination of Low NO_x burners, SCRs, and SNCR equipment on various generating units. Installation of these additional NO_x controls occurred in 2006-2007. To control emissions of SO₂, PEC either has or intends to install desulfurization equipment (scrubbers) on its Asheville, Roxboro, Mayo, Sutton and Cape Fear coal-fired generation facilities. Installation of the additional SO₂ controls began in 2005 and is expected to continue through 2013.

In March 2005, the EPA issued a final rule known as the Clean Air Interstate Rule (“CAIR”). CAIR required the District of Columbia and twenty-eight (28) states, including South Carolina, to reduce their SO₂ and NO_x emissions in order to attain new federally mandated air quality levels. CAIR established annual emission limits to be met in two phases beginning in 2009 and 2015, respectively for NO_x and beginning in

2010 and 2015, respectively for SO₂. Again, the affected states were required to revise their SIPs to address the CAIR limits. The North and South Carolina SIPs required, among other things, the reduction of SO₂ emissions from coal-fired generating facilities. The SIPs also maintained NO_x SIP Call emissions limits and included the additional annual CAIR limits for NO_x which would become effective in 2009. CAIR and the resulting SIPs directly impacted PEC in that the CAIR limits were as restrictive as the CSA limits, or more so. Thus, the CSA basically required PEC to achieve the same level of controls as would be needed to comply with CAIR and the revised SIPs, only earlier than would otherwise have been the case.

On June 15, 2005, the EPA issued the final Clean Air Visibility Rule (“CAVR”). The EPA’s rule requires states to identify facilities, including power plants, that commenced operation between August 1962 and August 1977 with the potential to produce emissions that affect visibility in 156 specially protected areas, including national parks and wilderness areas, designated as Class I areas. To help restore visibility in those areas, states must require the identified facilities to install best available retrofit technology (“BART”) to control their emissions. PEC’s BART-eligible units are Asheville Units No. 1 and No. 2, Roxboro Units No. 1, No. 2 and No. 3, and Sutton Unit No. 3. The reductions associated with BART begin in 2013. The CAVR included the EPA’s determination that compliance with the NO_x and SO₂ requirements of the CAIR could be used by states as a BART substitute to fulfill BART obligations, but the states could require the installation of additional air quality controls if they did not achieve reasonable progress in improving visibility.

As explained below, the CAIR rule has been vacated. If that ruling is not overturned, reconsidered or stayed, it will negate the EPA's determination that implementation of the CAIR satisfies BART for SO₂ and NO_x for BART-affected units under the CAVR. Consequently, for BART-affected units, CAVR compliance will require consideration of NO_x and SO₂ emissions in addition to particulate matter emissions. As a result, BART for SO₂ and NO_x may now specifically apply to PEC's affected units. PEC is assessing the potential impact of BART and its implications with respect to PEC's plans and estimated costs to comply with the CAVR. At this point, it appears PEC will have to consider installing SCR at its Sutton 3 fossil plant to comply with the CAVR.

On July 11, 2008, the United States Court of Appeals for the District of Columbia Circuit vacated CAIR in its entirety. The court subsequently requested that the petitioners respond to the question of whether the court should stay its mandate pending development of a new rule by EPA. As of the date of this Petition, the EPA has not taken any action concerning the issuance of a new or revised rule addressing air quality standards. Nevertheless, PEC anticipates that the EPA will take some action in the future but at this time does not know what impact any newly issued rule will have on its electric utility operations.

Collectively, the NO_x SIP Call, CSA, CAIR, CAVR and the corresponding SIPs, have required PEC to install a substantial amount of Air Pollution Control ("APC") equipment to meet its emissions compliance requirements. As of October 31, 2008, PEC has incurred approximately \$1.4 billion in costs necessary to meet its environmental

controls compliance requirements.¹ Construction of the scrubbers and NOx controls continues today. PEC anticipates the total cost of installation of the APC equipment on its coal-fired generation fleet will be \$1.9-2.0 billion. As required by the CSA and the North Carolina Utilities Commission, PEC has already amortized against its North Carolina cost of service \$584 million of system APC costs.

After all of the scrubbers are installed and are operating they will be capable of reducing SO₂ emissions on PEC's system by approximately 74% from year 2000 levels. Moreover, the scrubbers will significantly reduce mercury emissions on PEC's system as well. PEC anticipates that all of its scrubbers will be operational by 2013. PEC has completed the installation of most NOx controls and through 2007 they have allowed PEC to reduce its NOx emissions by approximately 59%. These reductions in emissions will be a great benefit to the environment of North and South Carolina and the Southeast.

A significant amount of capital has already been invested by PEC. Although there is uncertainty regarding future action to be taken by the EPA, there are significant environmental benefits to be achieved through reduced SO₂ and NOx emissions, and the APC equipment PEC has installed will be critical to meeting future regulatory requirements. Therefore, PEC is continuing with the construction of these pollution control facilities.

The installation of the APC equipment is a significant capital investment and as a result, the annual depreciation expense associated with these assets will also be significant. At current depreciation rates, PEC anticipates that the annual depreciation

¹All cost and depreciation estimates included in this Application reflect system costs to be allocated among South Carolina retail customers, North Carolina retail customers, and wholesale customers (of which the South Carolina allocable portion is approximately 14.25%).

expense associated with its environmental controls will total approximately \$15-30 million.

Under Generally Accepted Accounting Principles ("GAAP") and in accordance with the Federal Energy Regulatory Commission's Uniform System of Accounts (as adopted by this Commission), the cost of assets such as the APC equipment is recorded on the Company's balance sheet as fixed assets and are charged to expense over the period in which these assets provide utility service and contribute to the earnings process. This systematic and rational allocation of an asset's costs over its service life and period of benefit is referred to as depreciation. Depreciation allows for the matching of expenses associated with a fixed asset to the revenue that the Company recognizes as a result of utilizing that asset to provide service. Under GAAP, this is referred to as the matching principle and is a fundamental concept in the accounting model. As part of electric utility rate-making, annual depreciation expenses are included within the utility's Commission approved base rates.

The large amount of annual depreciation expense that PEC expects to incur after installation of its APC equipment is not currently included within PEC's existing base rates. Therefore, this expense is not "matched" with revenue to be collected. With this mismatch of expense to revenue, this event is a fundamental departure from the matching principle.

In addition to the increased depreciation costs associated with the APC equipment, PEC will also experience an increase in incremental operation and maintenance costs. Although the amount of additional incremental operation and

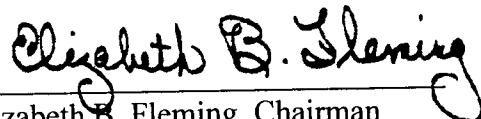
maintenance cost incurred will be dependent on various factors such as operational usage and pricing when these costs are incurred, the Company believes that these increased costs will be significant, based on industry experience.

If the Commission approves PEC's request, the Company would defer the South Carolina retail allocable portion of incremental depreciation expense of its APC equipment until such time as rate recovery for these assets is provided for in PEC's Commission approved base rates. Additionally, PEC would defer the South Carolina retail allocable portion of incremental operation and maintenance costs associated with its APC equipment and seek recovery of these deferred expenses in a future application with the Commission seeking approval to adjust its retail rates and charges in a general rate case proceeding. In such a proceeding, the Company would request an appropriate mechanism for the recovery of these deferred expenses. At the present time, PEC has not made a decision as to when the Company will seek recovery of these costs.

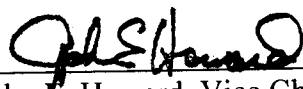
On December 12, 2008, the Office of Regulatory Staff filed a letter with the Commission indicating that it had no objection to PEC's request. We have also reviewed the request, and have determined the request to be consistent with the public interest. Accordingly, we grant PEC's request that it be authorized to begin deferring as a regulatory asset: (i) the depreciation expense that the Company incurs on its environmental compliance control facilities; and (ii) the incremental operation and maintenance expenses that PEC incurs in connection with its environmental compliance control facilities.

This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:


Elizabeth B. Fleming, Chairman

ATTEST:


John E. Howard, Vice Chairman
(SEAL)